WASHINGTON STATE LEGISLATURE

Office of the State Actuary

October 21, 2004

TO: Steve Nelsen, Executive Director
LEOFF 2 Retirement Board

FROM: Marty McCaulay, Associate Actuary
Office of the State Actuary

CC: Matt Smith, State Actuary
Office of the State Actuary

RE: CONTRIBUTION RATE STABILITY

This confirms what we discussed regarding the four years of weighted annual increases shown on page 7 of your September 22, 2004 report on Contribution Rate Stability. The present value of expected contributions over the four years is the same with or without smoothing.

While the present value of the cost of using the smoothed rates is zero, there is a cost on a cash flow basis, as shown in this exhibit:

LEOFF 2 Contribution Rate Stability
Weighted Annual Increases

Year	Total Rate Before Smoothing	Total Rate After Smoothing	Member	Employer*	State	Biennium Dollar Difference (millions)	
2003-05	10.18%	10.18%	5.09%	3.06%	2.03%		
2005-06	14.40%	13.50%	6.75%	4.05%	2.70%		
						($1.8)	for 2005-07
2006-07	14.40%	15.10%	7.55%	4.53%	3.02%		
2007-08	16.68%	16.60%	8.30%	4.98%	3.32%		
						$3.2	for 2007-09
2008-09	16.68%	16.97%	8.49%	5.09%	3.39%		
Total						$1.4	for 2005-09

* Excludes administrative expense charge.

2100 Evergreen Park Drive S.W., Suite 150
P.O. Box 40914
Olympia, WA 98504-0914
(360) 753-9144

FAX: (360) 586-8135
TDD: 1-800-635-9993

E-MAIL: actuary_st@leg.wa.gov

This schedule of proposed rates does not defer increases beyond the 4-year phase in period. On a present value basis, the deferral of rate increases during the first biennium is offset by rate increases during the second period.

This proposal would represent a departure from current funding policy and would require a statutory change to the funding policy. The schedule includes rates that are below the aggregate normal cost rates for the plan. It effectively borrows assets on a short term basis and repays them with interest at the assumed valuation rate of 8%.

The contribution rate projections are based on the assumptions documented in the 2002 valuation report. If the actual rates for the 2007-09 biennium differ from the projected rates (which is more likely than not), then the cost of using the rates after smoothing would no longer have a present value of zero unless the smoothed rates are adjusted.

We did not include any cost impact related to whether or not a floor contribution rate is established. A floor or minimum contribution rate would not impact rates in the long run. The short term increase in rates in years in which the floor applied would be offset by lower rates in future years. A floor could actually result in a long term savings to the extent that investment earnings from the extra contributions due to the floor are used to reduce future contribution requirements. We considered but did not include any cost impact for any issues related to market timing and when the extra contributions from the floor are invested.

The determination that a floor would result in no additional cost and possibly a savings is based on the assumption that any surplus or cushion that is built up from a floor is used to reduce future contribution requirements and not used to provide for benefit increases. If the extra contributions from a floor are used for benefit increases, then there would be a cost to having a floor.

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